

lessees), should be made in columns (b) and (c), as applicable, on line 36.

Complete Part III of Form 8916-A. Enter the amounts from line 5, columns (a) through (d) of Form 8916-A, on Schedule M-3, Part III, line 36, columns (a) through (d), as applicable. Attach Form 8916-A.

Do not report on Form 8916-A and this line 36 amounts reported in accordance with the instructions for Part II, lines 9, 10, 11, and 12.

Line 37. Domestic Production Activities Deduction

Report on Part III, line 37, column (d), the amount of the domestic production activities deduction under section 199 included in taxable income on Form 1120-L, page 1, line 20. Complete columns (b) and (c), as applicable. Do not report any portion of the corporation's domestic production activities deduction on any other line of Schedule M-3.

Line 38. Research and Development Costs

Report in column (a) the amount of expenses included in net income reported on Part I, line 11, that are related to research and development expense. Report in column (d) the amount of deductions included in Form 1120-L, page 1, line 19 that are recognized and reported as Section 174 research and experimental expenditures consistent with the corporation's adopted method of accounting for such expenditures. In column (c), as applicable, include any adjustments for any amounts treated for U.S. income tax purposes as research or experimental expenditures that are treated as some other form of expense for financial accounting purposes, or vice versa. Report any difference in timing recognition in column (b). For example, if the taxpayer's financial accounting method does not specify otherwise, column (b) adjustments include adjustments for timing differences between financial and tax accounting for: (1) deferral and amortization of research expenditures, (2) a section 59(e) election, (3) reduction of section 174 expenditures under section 280C or section 482, (4) costs attributable to obtaining a patent, (5) research in social sciences, and (6) cost elements for property of a character subject to depreciation.

Section 174 provides two methods for the treatment of research and experimental expenditures paid or incurred by a taxpayer in connection with the taxpayer's trade or business. These expenditures may be treated as expenses not chargeable to a capital account and deducted in the year in which they are paid or incurred, or they may be deferred and amortized. Since the method for treatment of research and experimental expenditures is adopted at the subsidiary level, the expense/deduction item is determined separately by each member of a U.S. consolidated tax group and not

at the U.S. consolidated tax group level. For example, U.S. Corporation P has two subsidiaries, A and B, which are included in P's consolidated financial statements and in P's consolidated U.S. income tax return. For financial purposes, P, A, and B recognize research and development cost as an expense when accrued. For U.S. income tax purposes, P and A recognize such costs consistent with the method used for financial purposes, whereas B capitalizes and amortizes such costs. P and A must report these expenses in columns (a) and (d). B must report its expense recognized in the financial statements when accrued in column (a); in column (d), B's research and development expenditures recognized for U.S. income tax purposes; and in columns (b) and (c), as applicable, the difference between B's research and development costs in its financial statements and its research and experimental expenditures for U.S. taxable income purposes.

Attach a schedule supporting the amounts reported on this line in columns (a), (b), (c), and (d). The schedule must separately state and adequately disclose the transactions summarized by this line.

The attached schedule should have five columns. The first column has the description for the next four columns. The second column is column (a) expense per income statement, the third column is column (b) temporary difference, the fourth column is column (c) permanent difference, and the fifth column is column (d) deduction per tax return. Every item listed on the attached schedule must always have columns (a) + (b) + (c) = (d). On the attached schedule, the column total amounts for columns (a), (b), (c), and (d) must equal the column amounts reported on this line.

The attached schedule may use a short description keyed to an expanded description in an additional attachment. The short description of the transaction should be phrased in such a way as to clearly identify (1) the account name under which the amount recorded in column (a) was recorded in the financial statements or books of the taxpayer, and (2) what adjustment is being recorded in either column (b) or column (c) for that transaction. The entire description is considered to be the tax description for the amount recorded in column (d) for that item.

Example 20. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2009 tax return and is required to file Schedule M-3 for its 2010 tax year. During 2010, X incurred \$100,000 of research and development costs that X recognized as an expense in its financial statements. Also, X incurred \$20,000 in attorney fees in obtaining a patent application that X capitalized and amortized in its financial statements. X recognized a \$2,000 amortization deduction. In compliance with its adopted method of accounting under section 174,

X deducts research and experimental expenditures for U.S. income tax purposes. Accordingly, X must report \$100,000 in column (a), \$20,000 in column (b), and \$120,000 in column (d). X must also report \$2,000 in column (a), (\$2,000) in column (b), and \$0 in column (d) on Part III, line 30, Other amortization or impairment write-offs.

Example 21. Assume the same facts as *Example 20* except Corporation X makes an annual election under section 59(e) to deduct \$80,000 of its \$120,000 of research and experimental expenditures over a 10-year period. Accordingly, X must report \$100,000 in column (a), a temporary difference of (\$52,000) (\$20,000 less (\$80,000/10 years X 9 years)) in column (b), and \$48,000 in column (d). X must also report \$2,000 in column (a), (\$2,000) in column (b), and \$0 in column (d) on Part III, line 30, Other amortization or impairment write-offs.

Example 22. Assume the same facts as *Example 21* except Corporation X elected to capitalize and amortize its research and expenditures over 60 months with respect to all its research programs for U.S. tax purposes. X first realized benefits from such expenditures on August 1. Accordingly, X must report \$100,000 in column (a), a temporary difference of (\$90,000) (\$20,000 less (\$120,000/60 months X 55 months)) in column (b), and \$10,000 in column (d).

Example 23. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2009 tax return and is required to file Schedule M-3 for its 2010 tax year. X adopted the current expense method to research and experimental expenditures for U.S. income tax purposes. During 2010, X incurred \$50,000 of research and development costs that X recognized as an expense in its financial statements. Also, X undertook to develop a new machine for its business. X expended \$30,000 on the project of which \$10,000 represents actual costs of material, labor, and component cost to construct the machine, and \$20,000 represents research costs not attributable to the machine itself. X capitalized all costs of \$30,000 related to the machine and recognized \$6,000 of depreciation expense in its financial statements. X's depreciation expense on the \$10,000 of costs related to the machine itself was \$2,000 for U.S. income tax purposes. Accordingly, X must report \$50,000 in column (a), \$20,000 (research costs which are not attributable to the machine itself) in column (b), and \$70,000 in column (d). X must also report \$6,000 in column (a), (\$4,000) in column (b), and \$2,000 in column (d) on Part III, line 32, Depreciation.

Example 24. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2009 tax return and is required to file Schedule M-3 for its 2010 tax year. During 2010, X incurred \$10,000 of research and development

costs related to social sciences that it recognized as an expense in its financial statements. X adopted the current expense method to research and experimental expenditures for U.S. income tax purposes. Because such costs are not allowable costs under section 174, X must report \$10,000 in column (a), permanent difference (\$10,000) in column (c), and \$0 in column (d). If such costs are otherwise deductible for U.S. income tax purposes, X must report this item of expense on Part III, line 40, Other expense/deduction items with differences.

Example 25. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2009 tax return and is required to file Schedule M-3 for its 2010 tax year. During 2010, X paid \$75,000 to acquire or in-license intangible assets under a collaborative arrangement with another company that X recognized as a research and development expense in its financial statements. X adopted the current expense method to research and experimental expenditures for U.S. income tax purposes. Because payments made to acquire rights to a product or technology are excluded costs from the definition of research and experimental expenditures, X must report \$75,000 in column (a), (\$75,000) in column (c), and \$0 in column (d). X must report any amortization otherwise allowable related to the payments on Part III, line 30, Other amortization or impairment write-offs.

Example 26. Corporation X is a calendar year taxpayer that was required to file Schedule M-3 for its 2009 tax return and is required to file Schedule M-3 for its 2010 tax year. X adopted the current expense method for research and experimental expenditures for U.S. income tax purposes. During 2010, X incurred \$100,000 of research and development costs that X recognized as an expense for both financial accounting and U.S. income tax purposes. A portion of the expenses were credit eligible expenses, and X claimed a research credit of \$1,000. X did not make the reduced credit election under section 280C. Accordingly, since X's financial accounting method does not specify otherwise, X must report \$100,000 in column (a), (\$1,000) (reduction of research and experimental expenditures to the extent of the credit amount) in column (b), and \$99,000 in column (d).

Line 39. Section 118 exclusion

Report on line 39 any inducements received in the current year and treated as contributions to the capital of a corporation by a non-shareholder. Report in column (a) any income amount as a negative number and any expense amount as a positive number.

Corporations must identify on an accompanying schedule referencing line 39 the fair market value of land or other property (including cash) provided to the corporation by any non-shareholder,

including a governmental unit or civic group, as an inducement, or for any other purpose. Include inducements for the corporation to locate its business in a particular state, municipality, community, or locality for the purpose of enabling the corporation to expand its existing operating facilities, including corporate headquarters, distribution center(s), or factory(ies) ("inducements").

On the accompanying schedule also identify any inducements that include refundable or transferable tax credits, including transferable credits that were sold.

The schedule must separately state, adequately disclose, and identify all of the dollar amounts summarized by this line. An accompanying schedule is required even if there are no dollar amounts reported on line 39.

Line 40. Other Expense/ Deduction Items With Differences

Separately state and adequately disclose on Part III, line 40, all items of expense/ deduction that are not otherwise listed on Part III, lines 1 through 39.

Attach a schedule that describes and itemizes the type of expense/deduction and the amount of each item, and provides a description that states the expense/deduction name for book purposes for the amount recorded in column (a) and describes the adjustment being recorded in column (b) or (c). The entire description completes the tax description for the amount included in column (d) for each item separately stated on this line.

The schedule of details attached to the Schedule M-3 for line 40 must separately state and adequately disclose the nature and amount of the expense related to each reserve and/or contingent liability. The appropriate level of disclosure depends upon each taxpayer's operational activity and the nature of its accounting records. For example, if a corporation's net income amount reported in the income statement includes anticipated expenses for a discontinued operation as a single amount, and its general ledger or other books, records, and workpapers provide details for the anticipated expenses under more explanatory and defined categories such as employee termination costs, lease cancellation costs, loss on sale of equipment, etc., a supporting schedule that lists those categories of expenses and their details will satisfy the requirement to separately state and adequately disclose. In order to separately state and adequately disclose the employee termination costs, it is not required that an anticipated termination cost amount be listed for each employee, or that each asset (or category of asset) be listed along with the anticipated loss on disposition.

The attached schedule should have five columns. The first column has the description for the next four columns. The second column is column (a) expense per income statement, the third column is column (b) temporary difference, the fourth column is column (c) permanent difference, and the fifth column is column (d) deduction per tax return. Every item listed on the attached schedule for line 40 must always have columns (a) + (b) + (c) = (d). Each item with amounts in columns (a), (b), (c), and (d) will be totaled and included as one line on line 40 on the face of the schedule.

Comprehensive income. If any "comprehensive income" as defined by SFAS No. 130 is reported on this line, describe the item(s) in detail as, for example, "foreign currency translation adjustments—comprehensive income" and "gains and losses on available-for-sale securities—comprehensive income."

Reserves and contingent liabilities. Report on line 40 amounts related to the change in each reserve or contingent liability that is not required to be reported elsewhere on Schedule M-3. For example: (1) amounts relating to changes in reserves for litigation must be reported on Part III, line 13, Judgments, damages, awards, and similar costs; and (2) amounts relating to changes in reserves for uncollectible accounts receivable must be reported on Part III, line 33, Bad debt expense/agency balances written off. See *Example 9* and *Example 27*.

Report on Part III, line 40, the amortization of various items of prepaid expense, such as prepaid subscriptions and license fees, prepaid insurance, etc.

Report on line 40, column (a), expenses included in net income reported on Part I, line 11, that are related to reserves and contingent liabilities. Report on line 40, column (d), amounts related to liabilities for reserves and contingent liabilities that are deductible in the current tax year for U.S. income tax purposes. Examples of reserves that are allowed for book purposes, but not for tax purposes include restructuring reserves, reserves for discontinued operations, and reserves for acquisitions and dispositions. Only report on line 40 items that are not required to be reported elsewhere on Schedule M-3, Parts II and III.

Example 27. Life insurance company Q is a calendar year taxpayer that was required to file Schedule M-3 for its 2009 tax year and is required to file Schedule M-3 for its 2010 tax year. On July 1 of each year, Q has a fixed liability for its annual insurance premiums on its home office building that provides a 12-month coverage period beginning July 1 through June 30. In addition, Q historically prepays 12 months of advertising expense on July 1. On July 1, 2010, Q prepays its insurance premium of \$500,000 and advertising expenses of \$800,000. For statutory accounting

purposes, Q capitalizes and amortizes the prepaid insurance and advertising over 12 months. For U.S. income tax purposes, Q deducts the insurance premium when paid and amortizes the advertising over the 12-month period. In its annual statement, Q treats the differences attributable to the annual statement treatment and U.S. income tax treatment of the prepaid insurance and advertising as temporary differences.

Q also has a Legal reserve where \$300,000 was expensed for financial accounting purposes and a (\$100,000) temporary difference was calculated to arrive at the income tax deduction of \$200,000. The schedule attached to Q's return for Part III, line 40 must be

separately stated and adequately disclosed as follows:

Description	Column (a) Expense per Income Statement	Column (b) Temporary Difference	Column (c) Permanent Difference	Column (d) Deduction per Tax Return
Prepaid insurance premium expensed not capitalized	\$250,000	\$250,000	-0-	\$500,000
Legal expense reserve	\$300,000	(\$100,000)	-0-	\$200,000
Total Line 40	<u>\$550,000</u>	<u>\$150,000</u>	<u>-0-</u>	<u>\$700,000</u>

Line 41. Total Expense/ Deduction Items

Report on Part II, line 27, columns (a) through (d), as applicable, the negative of the amounts reported on Part III, line 41, columns (a) through (d), as applicable. Report positive amounts as negative and negative amounts as positive. For example, if Part III, line 41, column (a), reflects an amount of \$1 million, then report on Part II, line 27, column (a), (\$1 million). Similarly, if Part III, line 41, column (b), reflects an amount of (\$50,000), then report on Part II, line 27, column (b), \$50,000.